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SUBJECT: PORTUGAL TO TRANSFER CAHORA BASSA DAM TO MOZAMBIQUE

REF: WYSHAM-HARRINGTON PHONE CALL NOVEMBER 3

¶1. On November 2 representatives of the Mozambican and Portuguese governments signed in Lisbon a memorandum of understanding (MOU) providing for the transfer of control over Cahora Bassa, the large hydroelectric dam on the Zambezi river in west central Mozambique, from Portuguese to Mozambican hands in the near future. The MOU, signed by Portuguese Finance Minister Texeira dos Santos and Mozambican Energy Minister Namburete and announced by visiting Mozambican President Guebuza and Portuguese Prime Minister Socrates, is seen in Mozambique as a milestone for the country's sovereignty as well as an advance in relations with Portugal.

¶2. The Portuguese government finished construction of the 2,075 mW dam in 1974, one year before Mozambique's independence. After 1975 Portugal continued to operate the dam and remained the majority share holder. The dam's main customer has been South African electricity utility Eskom, and under a 2004 agreement the price the dam holding company (HCB) receives for its exports to Eskom will rise from 5 cents/kwh to 10 cents/kwh in 2006 and 16 cents/kwh in 2007. Electricity from HCB also is exported to Zimbabwe, which in recent years has accumulated payment arrears. Portuguese control over Cahora Bassa has long been a sore point in Maputo's relations with Lisbon. For years the sticking point in negotiations was HCB's debt to the Portuguese treasury. This debt had risen to some usd 2.3 billion because of HCB's failure to make scheduled payments for years while the dam was idle during Mozambique's civil war. Portugal insisted on resolution of the debt before it would turn over control of the dam, and Mozambique lacked the capacity to assume the debt.

¶3. Under the MOU, the GRM's ownership stake in HCB will rise from 18 percent to 85 percent and Portugal's will fall from 82 percent to 15 percent. HCB will pay the Portuguese government USD 250 million in two equal payments in January and October 2006 and will settle the remainder of its debt to Portugal by paying usd 700 million within a year of the final agreement. It thus appears that Mozambique will take on an additional usd 400 million in obligations to Portugal (85 percent of usd 950 million minus 18 percent of usd 2.3 billion) in return for the 67 percent of HCB it will acquire.

¶4. Both sides, apparently, hope that a final agreement can be signed by the end of this year. However many of the details of the transfer remain for negotiation, we understand. Subsequent meetings are scheduled for November 21-22 and December 16-17, according to the press.

¶5. Comment: The Mozambican media is hailing the MOU as a major diplomatic coup by President Guebuza, and celebrating the signing as a big boost to national pride. "Its Ours!"

shouts today's issue of independent weekly Savana, with the headline splashed across a large photo of the dam on its cover. Cahora Bassa has tremendous economic, as well as symbolic, importance here. Exports from Cahora Bassa constitute a major income earner for this poor country, bringing in more than USD 100 million annually, an amount that will likely rise with the higher price of sales to Eskom. There is a growing appetite for power in South Africa and the region. With the dam under Mozambican control, and therefore under a more simplified management/payment structure, we anticipate renewed interest in expanding Cahora Bassa's output (a second power station, on the north side of the dam) and consideration of constructing other cascades further downstream. But first an agreement must be signed. And, for that matter, it is not yet clear how Mozambique will obtain the funds needed to pay its new obligations.

La Lime